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No. 78-1033

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1978

SOUTHLAND ROYALTY COMPANY, *Petitioner*

v.

UNITED STATES OF AMERICA, *Respondent*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Reply to Memorandum in Opposition

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The purpose of this Reply is to bring attention to the errors in the Memorandum for the United States in Opposition to Petitioner's Petition for a Writ of Certiorari.

Primarily, the Memorandum glosses over the true nature of the issue in the Court of Claims. The issue really was the deductibility of expenses incurred in state court litigation over the date of termination of a lease. The origin of the litigation was interference by the Texas Railroad Commission with the regular operations and management of the lease. The Memorandum employs labels that are not supported by the facts of this case. For example, the Memorandum in its very first sentence characterizes the underlying

state court proceeding as a determination of Petitioner's "right to a reversion under an oil lease agreement." Petitioner's "right to a reversion" was not the issue in the case, nor was it "determined" by the Court. In fact, all parties admitted and assumed that Petitioner unquestionably owned full rights to the reversion. Actually, the question was only the *time* when the reversion would occur. This distinction is material, and the refusal to recognize it is error. The purpose for the Memorandum's error is to attempt to avoid the judicial precedents and statutory provisions that entitle Petitioner to prevail on the established facts.

The Memorandum in Opposition further errs in stating that "the origin and principal purpose of the expenses centered on Petitioner's claims to unfettered title to the land." This is a misleading over-simplification of the Court of Claim's ruling and of the undisputed record below.

The Court of Claims did not base its decision on the "origin" of the expenses at issue. At no point did the majority of the split court refer to the origin of the litigation in which Petitioner incurred the expenses at issue here. That reason alone calls for this Court's grant of the Writ of Certiorari. The lower Court's failure to follow the "origin" principle established by this Court is reversible error as a matter of law. Further, Petitioner is entitled to prevail if the facts concerning the origin of the litigation are heeded, as the dissenting opinion below so cogently demonstrates. The record and findings of fact are diametrically opposed to Respondent's characterization of the facts in

this case. The lower Court's disregard of the facts in this case has denied Petitioner its day in court. The 2-1 majority in the Court of Claims failed to follow either the law or the facts in this case.

The Memorandum on page 3 misquoted this Court's holding in *Woodward v. Commissioner*, 397 U.S. 572, 576 (1970). That decision mandates the application of the "origin" principle, not the "principal purpose" doctrine. The opinion states "that the 'primary purpose' test has no application here." Petitioner submits, alternatively, that it is entitled to prevail, even under the principal purpose doctrine, due to the findings of fact by the Trial Judge. The Court below has totally disregarded these controlling elements, upon the additional erroneous legal premise that "purpose" and "origin" are legal, not factual, questions.

The Memorandum on page 4 cites dictum in the case of *Industrial Aggregate Company v. United States*, 284 F. 2d 639 (8th Cir. 1960), to support its position. As pointed out in the Petition, that case held for the taxpayer that expenses related to construing the time for a lease to terminate are deductible currently. The entire state case involved the effect of interference with operations under the lease.

The Memorandum refers repeatedly to "unfettered title" as the issue below. Title has never been an issue, much less the central issue. It is grievous error to characterize a declaratory judgment action to determine the effect on a lease of interferences with everyday management and operation of income producing property as a suit over "title." Respondent's position,

however incorrect, is understandable, because without the catch-word "title" to describe the suit, Respondent's position is wholly indefensible. For that reason, it is essential that the Trial Judge's findings and the record, both well expounded in the dissenting opinion, be examined to expose the fallacy of Respondent's characterization of this suit. Petitioner submits that Respondent's apparent casual approach to this Petition is to mask its weakness on the merits of the case.

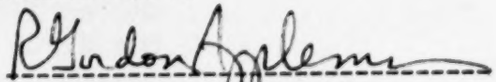
Respondent does admit on page 4 of its Memorandum that the "expenses originated in claims relating to property held for the production of income." This admission brings Petitioner literally within the terms of the Treasury Regs. Section 1.212-1 (b) and (k), which allow the deduction claimed. It would not be fatal to the deduction even if the expenses "also related directly to 'title' to that property," where, as here, any such "title relationship" if it did exist, which Petitioner denies, would be merely secondary or incidental. Most important is the "origin" of the expense, not its "relationship" to some remote title issue. See *Industrial Aggregate Company*, supra, *Woodward*, supra, *United States v. Hilton Hotels Corporation*, 397 U.S. 580 (1970).

In its final sentence, the Memorandum further admits that the issue was "possession." What it did not state, but which is the fact, is that the only aspect of "possession" in issue was the date or timing of a change in possession, which carried with it management and operation of, and income from, the lease. These are not capital transactions, and the related

expenses should not be capitalized as part of the cost of a property.

As the issue is thus more accurately identified, the overwhelming judicial precedent is in favor of Petitioner's Writ of Certiorari. See *Bliss v. Commissioner*, 57 F. 2d 984 (5th Cir. 1932), *Tucker v. Commissioner*, 9 T.C.M. 956 (1950), *Herman A. Moore Trust v. Commissioner*, 49 T.C. 430 (1968), and *Industrial Aggregate Company* supra.

Even with a 30 day extension, Respondent was able only to produce a position that is superficial and misleading in its oversimplification and generality. Petitioner submits that the true character of this case merits the grant of a Writ of Certiorari to reverse the error of the split decision below.



R GORDON APPLEMAN

Proof of Service

I, R GORDON APPLEMAN, attorney for Southland Royalty Company, Petitioner herein, and a member of the Bar of the Supreme Court of the United States hereby certify, that, on the 6th day of April, 1979, I served copies of the foregoing Reply to Memorandum in Opposition to the United States Court of Claims on the Respondent, The United States, by mailing a copy in a duly addressed envelope with postage prepaid, to Wade H. McCree, Jr., Esquire, Solicitor General, Department of Justice, Washington, D.C. 20530.

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